

Kellogg Company (K)

\$66.31 (As of 07/02/20)

Price Target (6-12 Months): **\$70.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 04/01/20)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:B

Value: C

Growth: A

Momentum: D

Summary

Shares of Kellogg have outperformed the industry in the past one year. The company has been recently benefiting from increased global demand for packaged food products amid the coronavirus-led stockpiling. This also helped the company retain its organic sales trend in first-quarter 2020, wherein both top and bottom lines beat the consensus mark. Notably, organic sales were solid in all regions and categories. However, earnings and sales fell year over year due to the divestiture of the cookies, fruit snacks, pie crusts and ice-cream cones businesses along with currency woes. These headwinds are likely to persist. Also, costs associated with operations amid the pandemic may hit margins. Nonetheless, Kellogg is likely to keep gaining from its Deploy for Growth strategy as well as a strong brand portfolio, supported by prudent buyouts and innovation.

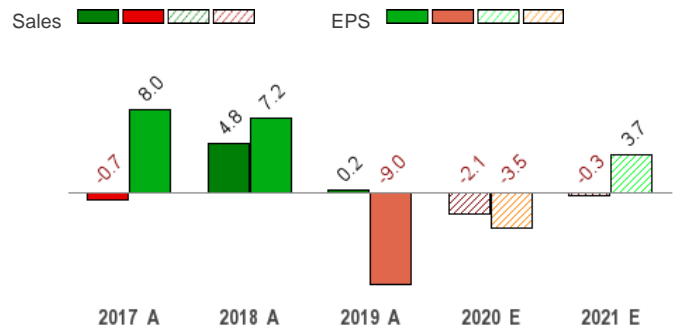
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$71.05 - \$52.66
20 Day Average Volume (sh)	2,638,135
Market Cap	\$22.7 B
YTD Price Change	-4.1%
Beta	0.57
Dividend / Div Yld	\$2.28 / 3.4%
Industry	Food - Miscellaneous
Zacks Industry Rank	Top 26% (66 out of 252)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	5.3%
Last Sales Surprise	0.1%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	08/06/2020
Earnings ESP	0.0%
P/E TTM	16.9
P/E F1	17.5
PEG F1	3.9
P/S TTM	1.7

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	3,310 E	3,237 E	3,325 E	3,237 E	13,251 E
2020	3,412 A	3,252 E	3,281 E	3,350 E	13,289 E
2019	3,522 A	3,461 A	3,372 A	3,223 A	13,578 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.99 E	\$0.97 E	\$1.02 E	\$0.96 E	\$3.94 E
2020	\$0.99 A	\$0.93 E	\$0.94 E	\$0.95 E	\$3.80 E
2019	\$1.01 A	\$0.99 A	\$1.03 A	\$0.91 A	\$3.94 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 07/02/2020. The reports text is as of 07/06/2020.

Overview

Headquartered in Battle Creek, MI, **Kellogg Company (K)** manufactures and markets ready-to-eat cereals and convenience foods (including cookies, crackers, toaster pastries, cereal bars, fruit-flavored snacks, frozen waffles and veggie foods), and savory snacks. The company has a balanced portfolio of cereal and snack products.

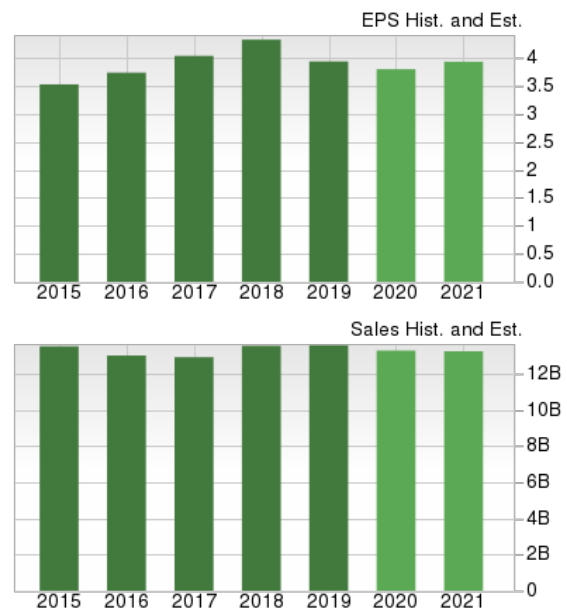
Kellogg's products are manufactured in 20 countries and marketed across 180 nations. Principal markets for the products offered include the United States and United Kingdom.

We note that earlier the company reported results under seven segments namely; U.S. Snacks, U.S. Morning Foods, U.S. Specialty Channels, North America Other, Europe, Latin America and Asia Pacific. The U.S. Snacks unit includes items such as crackers, cookies, cereal bars, savory snacks and fruit-flavored snacks. The U.S. Morning Foods unit consist of mainly cereals and toaster pastries. U.S. Specialty Channels consists of food away from home channels, including food service, convenience, vending and food manufacturing. Further, the North America Other unit includes U.S. Frozen, Kashi, Canada, and RX operating segments. The remaining segments are based on geographical locations, namely; Europe, Latin America and the Middle East and Northern Africa.

Concurrent to its fourth-quarter 2018 results, Kellogg unveiled some changes related to its segments for 2019. As part of its efforts to reorganize its North America region, the sub divisions – U.S. Snacks, U.S. Morning Foods, U.S. Specialty Channels and North America Other – have been removed.

Further, the company has transferred its Middle East, Turkey and North African businesses from Kellogg Europe to Kellogg Asia-Pacific. Kellogg Asia-Pacific has been rechristened as Kellogg Asia, Middle East & Africa. As per these changes, the company now reports its quarterly outcomes under four segments, namely; North America, Europe, Latin America and the Asia, Middle East & Africa or AMEA region.

In 2019, the company generated sales of \$13.6 billion (61.8% from North America, 15.4% from Europe, 6.9% from Asia-Pacific and 15.9% from Latin America).



Reasons To Buy:

- ▲ **COVID-19 Led Stock Piling Keeps Organic Sales Trend Intact:** Shares of Kellogg have gained 19.6% in the past year, against with the industry's dip of 3.7%. The company has been recently benefiting from increased demand for packaged food products amid the coronavirus-led stockpiling. Such trends also helped the company retain its organic sales trend in first-quarter 2020. In the first quarter of 2020, organic sales (excluding currency and divestitures) moved up 8% to \$3,464 million. Management highlighted that more than half of the first-quarter growth was attributable to increased buying of consumers due to the coronavirus-led stockpiling. Notably, organic sales were backed by underlying business growth across categories and regions. In North America, the company witnessed consumption gains in core brands and categories along with increased shipments to support burgeoning demand for packaged food amid the coronavirus-led lockdown. Sales in all other regions were also backed by increased demand for packaged foods due to higher at-home consumption.
- Kellogg boasts robust organic sales trend. Further, the company is on-track with building brands and expanding presence in the emerging regions.
- Prior to this, organic sales had improved 2.7% each in the fourth and third quarters of 2019. Further, it increased 2.3% and 0.3% in the second and the first quarters, respectively. Management still expects organic sales to grow 1-2% in 2020, though it now expects sales and profits to flow in more during the first half.
- ▲ **Lucrative Buyouts:** In line with the strategy to diversify its organic offerings, Kellogg acquired protein bar maker, Chicago Bar Company, in 2017. Chicago Bar Company makes RXBAR, which is considered the one of the fastest growing nutrition bar brand in the United States. RX now forms part of Kellogg's organic revenues. Additionally, the company's Pringles buyout has been lucrative. Markedly, with the 2012 Pringles deal, Kellogg transformed itself from what was essentially a large U.S. snacks business to a true global snacks player. Also, the consolidation of Multipro (completed in May 2018), a Nigerian food distributor has been yielding. Markedly, these acquired businesses are expected to continue supporting the company's business. Kellogg also continues to expand its acquired brands through new product introductions.
- ▲ **Growth Efforts on Track:** Kellogg's productivity saving initiatives, have been on track. In this respect, the company is striving toward building a better cost structure. We note that the company successfully completed the Project K program. Savings from this program are being invested in brand-building initiatives, improve logistics, sales capabilities and innovation.
- Further, the company is on track with the Deploy for Growth strategy, and is accordingly undertaking efforts to restructure portfolio. As part of portfolio restructuring efforts, the company completed the sale of certain snacks, cookies, crusts and ice cream businesses in July, 2019. Though this divestiture is likely to weigh on the company's results in the near term, such efforts are likely to aid focusing on other lucrative business platforms and achieve greater efficiency. Moreover, the divestitures have helped the company to reduce debt and improve its financial position.
- ▲ **Strong Brand Portfolio:** Kellogg boasts a legacy of over 100 years built on solid product portfolio and brand identity in both cereals and snacks. Its portfolio consists of strong brands such as Pringles, RXBAR, Bear Naked, Cheez-It, Rice Krispies Treats among many others. The company's frozen foods brands like Morningstar Farms and Eggo have also been depicting strong growth. Kellogg is also dedicated toward augmenting its portfolio through adding more products under existing brands, innovation and marketing initiatives. The company has been focused on investing in brand-building efforts. In this respect, it invests in digital media, consumer promotions and traditional advertising. Kellogg has also been enhancing its in-store capabilities like increasing sales force of its struggling businesses.
- ▲ **Financial Analysis:** As of the end of first-quarter 2020 (Mar 28, 2020), Kellogg's long-term debt (including operating lease liabilities) remained almost stable sequentially at \$7.6 billion. Management commented that it is in a favorable financial position amid the pandemic. Apart from solid cash balance, Kellogg has good access to commercial paper. Also, it has backup funding worth \$2.5 billion. Moreover, the company's times interest earned ratio improved sequentially, from 5.6 as of the end of the fourth quarter to 6.1 as of the first-quarter-end. The ratio is also better than the industry's 3.7.
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Reasons To Sell:

▼ **Divestitures Hurt Q1 Performance, Outlook Dismal:** Kellogg delivered first-quarter 2020 net sales of \$3,412 million, which slipped 3.1% year over year. The downside can be attributed to impacts from the divestiture of the company's cookies, fruit snacks, pie crusts and ice-cream cones businesses. Absence of the divested businesses dragged down sales by about 9% in the first quarter and exerted pressure on the company's North American unit. Also, currency headwinds had a roughly 2% impact on the top line.

Adverse impacts from divestitures and currency rates as well as rising input costs are headwinds for Kellogg.

Moreover, adjusted operating profit fell 5.7% to \$439 million due to currency headwinds and the absence of the divested businesses. The divestitures also negatively impacted the bottom line, which dipped 2% year over year to 99 cents per share. For 2020, adjusted operating profit is expected to decline 4% at cc and adjusted earnings to drop 3-4% at cc due to divestiture impacts.

▼ **Currency Headwinds:** Kellogg's solid international presence keeps the company exposed to risks associated with overseas operations. Volatile currency movement is one such risk. Notably, adverse currency rate hurt the company's top line by 2% in the first quarter and kept the adjusted operating profit under pressure. Currency headwinds are expected to persist and increase in the near term.

▼ **Elevated Costs:** Kellogg has been struggling with rising input costs. During the first quarter, its gross margin was hampered by input cost inflation. Apart from this, the company has been incurring elevated costs related to operations amid the pandemic. The company is investing in employee safety and undertaking increased cleaning and sanitization measures. Further, it is making investments in information technology to support remote working. These along with higher production and logistic costs are likely to exert some pressure on margins.

▼ **Concerns Over Emerging Markets:** Though Kellogg's organic sales grew in the emerging markets in the first quarter, management remains cautious of the company's performance in these regions with recession concerns looming over the economy. Notably, emerging markets are usually more susceptible to recessionary environment. In fact, currencies in emerging markets have already weakened. All said, the company expects a soft emerging market performance in the near term.

▼ **Food Industry Headwinds:** The food industry grapples with stiff competition and aggressive promotional environment. The company faces intense competition from other food companies on the grounds of quality, prices and availability. To meet such competitive pressure effectively, Kellogg may have to lower prices or indulge in marketing activities to maintain market share. Additionally, since the company operates in a highly regulated nutritional food space, its products are frequently inspected by government agencies. Moreover, nutritional products usually have a lower shelf life which requires products to move off the shelves rapidly, to prevent expiry.

Last Earnings Report

Kellogg Q1 Earnings & Sales Beat Estimates, Down Y/Y

Kellogg reported first-quarter 2020 results, with both earnings and sales surpassing the Zacks Consensus Estimate. However, both metrics declined year over year due to impacts from the divestiture of the cookies, fruit snacks, pie crusts and ice-cream cone businesses (concluded in July 2019). However, results gained from a considerable increase in global demand for packaged foods in March, as the coronavirus-led stay-at-home trend has been leading consumers to hoard stocks.

Kellogg reiterated its guidance for 2020, expecting a shift in sales and earnings toward the first half of the year.

Quarter Ending 03/2020

Report Date	Apr 30, 2020
Sales Surprise	0.06%
EPS Surprise	5.32%
Quarterly EPS	0.99
Annual EPS (TTM)	3.92

Quarter in Detail

Adjusted earnings of 99 cents per share dipped 2% year over year, though it beat the Zacks Consensus Estimate of 94 cents. Results were hurt by the absence of divested businesses, partly compensated by growth in other businesses. On a constant-currency (cc) basis, adjusted earnings came in at \$1 per share, which dipped 1% from the year-ago quarter's figure.

The company delivered net sales of \$3,412 million, which slipped 3.1% year over year. Nevertheless, the figure surpassed the consensus mark of \$3,356 million. The year-over-year downside was caused by impacts from the divestiture of the company's cookies, fruit snacks, pie crusts and ice-cream cone businesses. Absence of the divested businesses affected sales by about 9%. Also, currency headwinds had a roughly 2% impact on the top line.

Organic sales (excluding currency and divestitures) moved up 8% to \$3,464 million. Management highlighted that more than half of the first-quarter growth was attributable to increased buying of consumers due to the coronavirus-led stockpiling. Apart from this, organic sales were backed by underlying business growth across categories and regions.

Adjusted operating profit fell 5.7% to \$439 million, owing to currency headwinds and the absence of the divested businesses. The metric dropped 4.4% to \$445 million at cc.

Segment Discussion

Sales in the **North America** segment amounted to \$2,097 million, down 8.4% due to divestiture impacts. Sales grew 6% on an organic basis, courtesy of consumption gains in core brands and categories along with increased shipments to support burgeoning demand for packaged food amid the coronavirus-led lockdown. Moreover, adjusted operating profit declined nearly 7% at cc.

Revenues in the **Europe** segment totaled \$526 million, up 5.9% year on year, despite currency headwinds. Further, sales rose about 9% on an organic basis, on the back of increased packaged food demand. Adjusted operating profit improved roughly 7% at cc.

Revenues in **Latin America** totaled \$226 million, up 0.8% year on year even amid major currency woes. Sales grew 11% on an organic basis, thanks to the coronavirus-led stock hoarding of packaged goods. Adjusted operating profit improved by 4% at cc on the back of improved sales.

Revenues in the **Asia, Middle East & Africa** segment totaled \$562 million, up 10% year over year, despite currency headwinds. Sales improved about 13% on an organic basis, backed by strength in emerging markets, especially Nigeria. Further, sales were backed by increased demand for packaged foods amid the coronavirus crisis in Australia, New Zealand, Japan and South Africa. Thanks to higher sales, adjusted operating profit rose 5% at cc.

Other Financials

Kellogg ended the quarter with cash and cash equivalents of \$1,016 million, long-term debt of \$7,163 million and total equity of \$3,212 million. In the first quarter, the company generated cash from operating activities of \$391 million.

Cash flow from operating activities is likely to be \$1.5-\$1.6 billion in 2020. Capital expenditures are expected to be roughly \$0.6 billion and cash flow is still expected in the range of \$0.9-\$1 billion.

2020 Guidance

Management reiterated its 2020 guidance. The company now expects sales and profits to flow in more during the first half. Organic sales in 2020 are still expected to grow 1-2%. Adjusted operating profit is expected to decline 4% at cc and adjusted earnings to drop 3-4% at cc due to divestiture impacts.

Recent News

Kellogg Declares Dividend – Feb 21, 2020

Kellogg's board approved a dividend of 57 cents per share, payable on Mar 16, 2020, to shareholders in record as on Mar 3, 2020.

Valuation

Kellogg's shares are down 4.1% in the year-to-date period and up 19.6% over the trailing 12-month period. Stocks in the Zacks sub-industry are down 9.8% in the year-to-date period, while the Zacks Consumer Staples sector declined 12.4%. Over the past year, the Zacks sub-industry rose 3.8% though the sector declined 11.5%.

The S&P 500 index is down 2.7% in the year-to-date period and up 5.6% in the past year.

The stock is currently trading at 17.13X forward 12-month earnings, which compares to 18.18X for the Zacks sub-industry, 19.37X for the Zacks sector and 22.36X for the S&P 500 index.

Over the past five years, the stock has traded as high as 22.71X and as low as 12.45X, with a 5-year median of 16.46X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$70 price target reflects 18.08X forward 12-month earnings.

The table below shows summary valuation data for K

Valuation Multiples - K					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	17.13	18.18	19.37	22.38
	5-Year High	22.71	22.9	22.38	22.38
	5-Year Low	12.45	14.82	16.64	15.15
	5-Year Median	16.46	19	19.95	17.42
P/S F12M	Current	1.71	1.62	9.26	3.48
	5-Year High	2.28	2.05	11.02	3.48
	5-Year Low	1.32	1.44	8.01	2.54
	5-Year Median	1.77	1.85	9.82	3.01
EV/EBITDA F12M	Current	13.33	13.77	33.35	12.16
	5-Year High	14.23	14.9	36.92	12.64
	5-Year Low	10.24	11.67	29.13	9.08
	5-Year Median	12.24	13.24	33.35	10.81

As of 07/02/2020

Industry Analysis Zacks Industry Rank: Top 26% (66 out of 252)



Top Peers

Company (Ticker)	Rec	Rank
BG Foods, Inc. (BGS)	Outperform	1
Conagra Brands Inc. (CAG)	Neutral	2
Campbell Soup Company (CPB)	Neutral	3
Flowers Foods, Inc. (FLO)	Neutral	2
General Mills, Inc. (GIS)	Neutral	3
JJ Snack Foods Corp. (JJSF)	Neutral	3
Nomad Foods Limited (NOMD)	Neutral	2
TreeHouse Foods, Inc. (THS)	Neutral	3

Industry Comparison Industry: Food - Miscellaneous				Industry Peers		
	K	X Industry	S&P 500	CPB	GIS	THS
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	3	3	3
VGM Score	B	-	-	A	A	B
Market Cap	22.72 B	3.57 B	21.98 B	14.90 B	37.27 B	2.43 B
# of Analysts	6	3	14	7	8	6
Dividend Yield	3.44%	0.00%	1.91%	2.84%	3.19%	0.00%
Value Score	C	-	-	A	B	C
Cash/Price	0.05	0.07	0.07	0.08	0.02	0.14
EV/EBITDA	14.16	13.13	12.74	13.21	14.76	28.27
PEG Ratio	3.88	3.83	2.89	2.03	2.35	2.57
Price/Book (P/B)	7.07	2.26	2.98	5.77	4.46	1.36
Price/Cash Flow (P/CF)	12.36	11.77	11.75	13.01	13.31	7.03
P/E (F1)	17.45	18.00	21.41	16.81	17.59	16.71
Price/Sales (P/S)	1.69	1.13	2.30	1.78	2.11	0.54
Earnings Yield	5.73%	4.91%	4.42%	5.94%	5.68%	5.98%
Debt/Equity	2.38	0.66	0.76	2.01	1.31	1.31
Cash Flow (\$/share)	5.36	2.68	6.94	3.79	4.62	6.13
Growth Score	A	-	-	B	B	A
Hist. EPS Growth (3-5 yrs)	3.30%	5.78%	10.93%	-2.14%	2.74%	-9.29%
Proj. EPS Growth (F1/F0)	-3.51%	4.87%	-9.56%	27.58%	-3.19%	7.95%
Curr. Cash Flow Growth	-9.43%	4.76%	5.51%	-12.42%	9.11%	-1.33%
Hist. Cash Flow Growth (3-5 yrs)	-0.49%	5.64%	8.62%	0.50%	1.32%	5.96%
Current Ratio	0.77	1.66	1.30	0.84	0.68	1.58
Debt/Capital	70.39%	40.14%	44.46%	66.79%	56.69%	56.69%
Net Margin	7.61%	2.56%	10.62%	18.34%	12.37%	-8.06%
Return on Equity	41.25%	12.01%	15.75%	46.05%	27.66%	7.25%
Sales/Assets	0.75	1.08	0.55	0.66	0.58	0.85
Proj. Sales Growth (F1/F0)	-2.13%	0.00%	-2.54%	-8.00%	-2.31%	-8.80%
Momentum Score	D	-	-	B	A	D
Daily Price Chg	0.58%	0.09%	0.47%	0.02%	1.74%	-0.09%
1 Week Price Chg	-5.78%	-2.23%	-3.90%	-1.51%	-3.85%	-12.32%
4 Week Price Chg	2.47%	0.28%	-3.77%	1.13%	1.18%	-12.89%
12 Week Price Chg	5.69%	7.07%	8.02%	3.29%	7.11%	-2.04%
52 Week Price Chg	17.01%	-4.66%	-7.59%	18.36%	13.14%	-23.75%
20 Day Average Volume	2,638,135	233,339	2,649,865	2,102,504	5,063,395	762,095
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.14%	0.00%
(F1) EPS Est 4 week change	0.00%	0.00%	0.00%	1.83%	0.25%	0.00%
(F1) EPS Est 12 week change	0.97%	-2.30%	-9.53%	8.61%	1.41%	2.31%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	-3.66%	4.74%	0.00%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	C
Growth Score	A
Momentum Score	D
VGM Score	B

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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